

Supreme Court of the United States

OCTOBER TERM 1938

THE BALTIMORE AND OHIO RAILROAD COMPANY, et al.,
Appellants

vs.

ABERDEEN AND ROCKFISH RAILROAD COMPANY, et al.,
Appellees

INTERSTATE COMMERCE COMMISSION,
Appellant

vs.

ABERDEEN AND ROCKFISH RAILROAD COMPANY, et al.,
Appellees

**ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR
THE EASTERN DISTRICT OF LOUISIANA,
NEW ORLEANS DIVISION**

**BRIEF FOR APPELLEES SOUTHERN
GOVERNORS' CONFERENCE ET AL.**

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QUESTIONS PRESENTED

The United States District Court for the Eastern District of Louisiana set aside two orders of the Interstate Commerce Commission which would have abandoned the basis of equality in dividing North-South freight revenues and substituted a basis under which the Northern railroads would receive a share of those revenues disproportionately larger than their share of the services performed in handling that freight. The district court's decision was based upon the fact that the Com-

mission's action was not supported by reasoned findings or substantial evidence. The questions presented by these appeals are:

1. Whether the district court invaded the province of the Interstate Commerce Commission in setting aside the orders of the Commission prescribing inflated divisions for the Northern railroads on the ground that such orders were based upon cost conclusions that were not supported by reasoned findings and substantial evidence as required by the Administrative Procedure Act?

2. Whether the district court properly concluded that the Commission had not acted lawfully in prescribing an inflation in the divisions of the Northern railroads on the basis of territorial average costs, without either findings or evidence to support the premise upon which that action rested — that is, that such costs are the product of and reflect inherent territorial disadvantages from which the North suffers as compared to the South?

3. Whether the district court properly concluded that the Commission cannot lawfully impose the burden of the higher transportation costs on one section of the country upon another section, even if such costs reflect inherent differences between the two sections, without findings as to whether the section being subsidized can support its own transportation system and whether the section being called upon for such subsidy can afford to provide it without undue harm to its economy?

STATEMENT

Twenty-one years ago, this Court handed down its historic decision in *New York v. United States*, 331 U.S. 284 (1947), upholding an order of the Interstate

Commerce Commission which struck down as unlawfully discriminatory the basic railroad class rate structure that had impeded the growth of the South since before the turn of the century. Prior to that case, railroad rates had consistently been higher in the South than in the North, and Southern shippers had been compelled to pay substantially higher charges to reach Northern markets than Northern shippers were paying to reach Southern markets, even where the distances involved were the same. The purported justification for this rate discrimination, which both the Commission and this Court rejected, was that the North has "natural advantages" over other sections of the country — such as a heavier "concentration of population" and "the preponderance of the nation's total natural resource of energy supply" — which made it "the logical location" for many industries (331 U.S. at 314). Because of these "natural advantages," it was contended that the North was entitled to lower rates than the South for the same amount and kind of rail service.

In rejecting this proffered justification for a discriminatory class rate structure, this Court acknowledged that the North did indeed enjoy certain immense advantages over other sections of the country. But it agreed with the Commission that these advantages were as much an effect of, as a cause for, the discriminatory rate structure (331 U.S. at 315):

"... It is sufficient at this point to say that the record makes out a strong case for the inference that natural disadvantages alone are not responsible for the retarded development of the South and the West, that the discriminatory rate structure has also played a part. How much a part cannot be determined, for every effect is the result of many factors. But the inference of prejudice from the dis-

criminary rate structure is irresistible. If this discriminatory rate structure is not justified by territorial conditions, then its continued maintenance preserves not the natural advantages of one region but man-made trade barriers which have been imposed upon the country...."

Hence, the Court rejected the suggestion that the advantages of the North were a justification for discrimination against the South, and it ordered that discrimination removed by putting into effect a uniform class rate structure. This was finally done in 1952, and for the first time in this century, the South enjoyed a position of equality with the North with respect to the cost of rail transportation.

Although the decision in *New York v. United States* had made it clear that there were no inherent differences in transportation conditions in the North and South, the Northern railroads refused to accept equality with the South. The Northern States having failed to convince the Court that the North was entitled to lower rates because of "natural advantages," the Northern railroads decided to pursue their aim of obtaining a preference for the North through precisely the opposite strategy — by seeking inflated divisions from North-South freight traffic to offset claimed Northern *disadvantages*.*

*In their Brief opposing our Motion to Affirm in this case, the Northern railroads took exception to this characterization of the strategy which they have pursued in these cases, claiming that it charges them with being "motivated by a purpose 'to keep the South in a permanent position of economic inferiority'" (Appellants' Brief Opposing Motion to Affirm, p. 13). (Emphasis added.) No such charge is made or intended here, for we are concerned with the effect of the Northern railroads' strategy, not its motivation. We do not deny that "The Northern lines accepted the Commission's decision in the *Class Rates* case" (*ibid.*) and the increase in their revenues which went along with it, nor do we challenge their implicit suggestion that their sole motivation throughout these cases has been their own financial aggrandizement. We only point out that the overall strategy pursued by all of the Northern interests has been formulated without regard to its effect upon the South, and that this strategy, if successful, would greatly harm the South.

During the period following the affirmance of the Commission's order in the *Class Rates* case and prior to the issuance of the orders of the Commission which are the subject of this litigation, revenues from North-South freight traffic were divided on an equal-factor basis — that is, both the Northern and the Southern railroads received a share of the revenues from that traffic based directly upon the amount of service they performed in handling it. This equal-factor basis of divisions was prescribed by the Commission itself to implement the principle of uniformity announced in the *Class Rates* case. *Official-Southern Divisions*, 287 I.C.C. 497, 523 (1953). Under this basis, each group of railroads received an identical share of the joint rate on any shipment involving an equal haul in each territory. Where one group of railroads performed more service than the other, that group received a larger share of the revenues, but the difference in divisions was directly related to the amount of service performed.

In 1956, however, only four years after the uniform class rate structure was put into effect, the Northern railroads filed a petition before the Interstate Commerce Commission claiming that they are entitled to *more* than an equal share of the North-South freight revenues based upon the amount of service they perform because the costs of performing rail service are higher in the North than in the South. They asked the Commission to prescribe a basis of divisions with inflated Northern factors which would have accorded them more than the Southern railroads for each unit of rail service performed.

As representatives of the interests of the people of the South, the Southern Governors' Conference and the Southeastern Association of Railroad and Utilities Commissioners intervened in the proceedings before the Com-

mission. Our participation in these proceedings was not designed to secure any special favor for the Southern public or for the Southern railroads. Quite the contrary, we took the position that all sections of the country should be treated *equally* — that, except where justified by the most imperative of special circumstances, each section should bear the costs of its own transportation system.

The Northern railroads' petition seeking an inflation in their divisions on the basis of claimed higher Northern costs raised two distinct groups of issues, each of which was thoroughly contested in the proceedings before the Commission. The first group of issues, to which most of the evidence and argument of the Southern railroads was directed, was whether costs on North-South freight traffic are actually higher in the North, as the Northern railroads asserted, for the same amount and kind of rail service. The Southern railroads sought to show that the claim of higher Northern costs was based entirely upon *territorial average costs* that did not measure the costs of performing rail services of the same amount and kind in both territories, which, of course, is the only relevant comparison since North-South freight traffic is, by definition, the same traffic in both territories. We joined in and supported the position of the Southern railroads on this issue.

The second, and by far the more important group of issues from the standpoint of these appellees, related to the question of whether, even assuming the Northern railroads' claim of higher costs to be valid, the Commission should prescribe an inflated basis of divisions to reflect such cost percentages. Our position was that the Commission should not force the railroads, and hence, indirectly the public, of one section of the country to subsidize the transportation system of another section, without some showing of special circumstances that

would justify and require shifting the burden of one section to another.

On February 3, 1965, and May 18, 1965, the Commission issued its orders in this case substantially granting the relief prayed for by the Northern railroads in their petition. The Commission's orders inflated the Northern railroads' divisions so that they receive, on the average, 17 percent more than the Southern railroads for the same amount and kind of service. These court proceedings were instituted to review the lawfulness of the Commission's prescription of this inflation.

The district court proceedings revolved principally about the question of whether the Commission's reports lawfully resolved the issues which had been presented to it. In granting the Northern railroads' request for an inflated basis of divisions, the Commission had discussed at length the contention that territorial average costs did not measure the costs of handling North-South freight traffic. But it had rejected that contention largely on the ground that there was no alternative to using territorial average costs, since no other cost data were available to it which had been prepared on a comparable basis in both territories. Moreover, the Commission had virtually ignored our contention that the North's divisions should not be inflated even if their costs of handling North-South traffic were somewhat higher than the South's. On this point, the Commission had said that "an adherence to uniformity as such, without a careful evaluation of the statutory criteria and the evidence of record" would not be proper (325 I.C.C. at 27; A.51). But the Commission had nowhere attempted to evaluate the evidence and arguments which we advanced to support a continuation of the principle of uniformity.

The district court found legal defects in the Commission's treatment of both these aspects of the case. It first

pointed out that the Commission's use of territorial average costs was not supported by reasoned findings or substantial evidence as required by the Administrative Procedure Act (A. 349):

"The Commission stated its exclusive standard to be the relevant cost of handling the specific freight traffic to which the divisions apply. We are persuaded that the order is not based on substantial evidence nor supported by reasoned findings within the meaning of Sections 8(b) and 10(e) of the Administrative Procedure Act because the use of territorial averages accounting for the Northern inflation has not been supported with findings of evidence relating any such inflation to the North-South Freight traffic."

The district court then went on to observe that the Commission had failed to follow similar statutory requirements in dealing with our contention that bare differences in cost, even if properly found to exist, should not automatically be reflected in interterritorial divisions (A. 351):

"[F]or many years prior to this case the Commission has consistently followed the view that the primary responsibility for meeting the cost and revenue needs of the railroads of any territory lies with the people and the industry of that territory. [citing cases] In this very case, prior to re-opening, the Commission held that the primary division of revenues accruing from this traffic were to be made on an equal-factor scale. We recognize that the Commission is not perpetually bound by their 1953 holding, but *we do believe that the Commission has special responsibilities in a case of this magnitude when it departs from its prior finding . . .*" (Emphasis added.)

Accordingly, the district court held that "upon remand, the Commission should decide and dispose of this contention in accordance with the Administrative Procedure Act" (A. 343). These appeals followed.

SUMMARY OF ARGUMENT

I.

The Commission's order granting an inflation in the divisions of the Northern railroads at the expense of the South was explicitly and solely based on the premise that Northern costs of handling North-South traffic were higher than Southern costs. However, in reaching this conclusion, the Commission relied upon unadjusted territorial average costs to measure certain critically important service factors which are performed in the course of hauling North-South traffic. This action of the Commission was contrary to law. The evidence in this case establishes conclusively that territorial averages do not measure the relative costs of the Northern and Southern railroads in handling North-South freight traffic. Indeed, the evidence shows that the use of such averages is inherently unfair to the South, since the territorial averages are higher in the North because the North is the beneficiary of a more advanced state of industrialization and economic development than the South. The North's greater output of manufactured goods, which requires special cars and special handling, and its need for such other expensive services as commuter passenger service, necessarily means that its average cost of handling all traffic will be higher for reasons that have nothing whatever to do with the costs of handling North-South traffic, which by definition is the same traffic in both territories. To use territorial averages to establish the proper relationship between the

North and the South in this *Divisions* case is to compel the South to subsidize the higher costs of handling traffic with which it has no contact and from which, therefore, it derives no benefit. The district court was plainly correct in holding that the Commission could not use territorial averages without some affirmative evidence that they actually measure the relative costs of handling North-South freight traffic.

II.

The district court was also correct in holding that the Commission had not dealt lawfully with the basic contention of the Southern Governors' Conference and the Southeastern Association of Railroad and Utilities Commissioners in this case.

Based on this Court's historic decision in *New York v. United States*, 331 U.S. 284 (1947), which sustained a Commission order establishing territorial equality in class rates between the North and South, we contended before the Commission that unequal divisions ought not be prescribed even on the basis of relative costs unless the higher costs of the preferred territory were found to be the product of inherent territorial disadvantages. As we read the Commission's report, it agreed that under the standard of the *New York* case, it could grant the Northern railroads inflated divisions only if it found that the North suffers from inherent territorial disadvantages. Hence, it purported to apply this test, holding that the cost differences between the North and South "are the product of, and reflect, the inherent advantages and disadvantages in the two territories" (325 I.C.C. at 28; A. 51). (Emphasis added.)

Commission counsel apparently interpret the Commission's report in the same way and seek to defend the

holding that the North suffers from inherent disadvantages. However, they cite neither findings in the Commission's report nor evidence in the record to support such a holding, and, in fact, there are no such findings or evidence. Moreover, the Commission's holding of inherent Northern disadvantages is directly contradicted by evidence that the Northern railroads presently seek through various mergers and consolidations to eliminate the non-inherent costs associated with overcapacity and wasteful duplication of facilities. The Commission itself acknowledged that waste is being eliminated from the Northern rail system, but it persisted in prescribing divisions reflecting costs including such waste until these Northern mergers are actually consummated and merger savings realized.

Throughout these proceedings, the Northern railroads have refused to defend the Commission's finding that the North suffers from inherent disadvantages, claiming instead that the Commission was merely commenting upon our contention. In these circumstances, the district court was uncertain whether the Commission had in fact resolved the issue of whether a finding of inherent disadvantage was a necessary prerequisite to a divisions inflation. The court observed that whether the Commission's statement is regarded as a finding or a comment, it could not lawfully support the Commission's action here, since the Commission had either failed to resolve a fundamental issue before it or had done so without reasoned findings or evidence. Accordingly, the district court directed the Commission to dispose of this issue on remand in accordance with the provisions of 8(b) of the Administrative Procedure Act.

III.

The district court also properly held that the Commission had not lawfully justified its abandonment of

the principle of uniformity, even apart from the question of whether the North suffers from any inherent disadvantages. A central question before the Commission was whether, even if the North's costs are unavoidably higher than those in the South, the South should be required to subsidize any part of such costs. In the proceedings before the Commission, we contended that it should not, relying upon the Commission's long established policy that each territory is primarily responsible for bearing its own transportation costs. We pointed to the absence of any evidence that the South was in a better position than the North to bear these supposedly higher Northern transportation costs.

The evidence indicated that the imposition of this Northern cost burden on the South would impede Southern efforts to attain economic and industrial parity with the North. Accordingly, we urged that any higher Northern costs found to be unavoidably incurred be met with rate increases within the North instead of divisional preferences as against the South. The Commission completely ignored this whole issue, making no ruling at all upon a specific exception presented to it on the point. The district court properly viewed this as erroneous. While recognizing that the Commission was not precluded from altering its previous policy, the court also correctly held that the Commission had failed to explain either its departure from equal-factor divisions or its abandonment of the principle that each territory must bear the primary responsibility for meeting the cost and revenue needs of the railroads which serve that territory.

ARGUMENT

The dominant technique of both of the appellants' briefs in this case is to treat the case as though it is a

mere squabble among railroads with no substantial significance from the standpoint of the public interest. Whether this technique represents a failure to comprehend the true importance of this case, or simply a strategy of submerging troublesome issues with which the appellants cannot effectively deal, we offer no opinion. Whatever may be the underlying reason for appellants' approach to the case, however, it is imperative that the impression they create be dispelled.

This case is of vital importance to the South and, indeed, to the entire country. At stake is nothing less than the question of whether there will be a free economy in this country, unhampered by artificial trade barriers which would prevent the free flow of transportation resources from one section of the country to another. The principle of uniformity in railroad rates and divisions guarantees a free flow of transportation resources. Differing levels of rates and inflated systems of divisions inevitably create barriers to free trade.

As the least prosperous section of the country, the South is vitally interested in the maintenance of freedom in the economy for, without it, the South may be walled into a position of permanent inferiority. However, although appellants contend otherwise (I.C.C. Brief p. 53), the principle of uniformity in rates and divisions is in no sense "sectional," for it guarantees every section of the country equal treatment. Thus, the principle not only offers a way to economic equality for those sections of the country that are currently lagging behind, but it also guarantees other sections that they will not be relegated to such inferior status.

In the final analysis, the principle of uniformity is designed to permit industry to come to people who need

work instead of requiring people to seek out industry. It is common knowledge that one of the major problems in this country has been the emigration of large numbers of people from the South. This has hurt the South by depriving it of its human resources while only creating problems of adjustment in other sections of the country. We believe that a part of the cause for this situation has been the discrimination against the South in matters as vital as railroad rates, which was only ended in 1952. This case would re-impose that discrimination in another form, for it would re-institute the very kind of barriers that have prevented a free flow of industry to the South with its ample supply of labor. This could only mean that the Southern labor force would again be compelled to seek out industry.

We recognize, of course, that these sorts of economic considerations are for the Commission, not for this Court. But that is precisely the problem — the Commission has totally ignored the economic ramifications of its action, treating the case as an intra-industry dispute. We urge the Court to take cognizance of the real issues in this case and to determine whether the Commission has resolved those issues in accordance with the Administrative Procedure Act. We submit that it has not.

I. THE DISTRICT COURT CORRECTLY SET ASIDE THE COMMISSION'S COST FINDINGS AS ARBITRARY AND UNSUPPORTED BY SUBSTANTIAL EVIDENCE.

In order to avoid repetition, we shall not restate here the many points made by the Southern railroads in their Brief in defending the district court's decision setting aside the Commission's orders because of legal defects in

the cost conclusions upon which those orders were based. Nor shall we discuss in detail each of the various arguments advanced by the appellants in attacking this aspect of the district court's holding, which are also dealt with in the Southern railroads' Brief. We are fully in agreement with the position taken by the Southern railroads that territorial average costs cannot conceivably be used on this record as a measure of the costs of handling North-South freight traffic. The record shows uncontroverted differences between North-South freight traffic and territorial average traffic in both those sections of the country with respect to each of the cost elements upon which the Northern railroads' inflation is based. In the face of these differences, the Commission's acceptance of territorial averages to measure the costs of North-South traffic was grossly arbitrary. The record does not show what the relative costs of handling North-South traffic actually are. But the district court was clearly correct in holding that this was the responsibility of the Northern railroads, as proponents of an inflation in their divisions, and of the Commission, as the agency charged with administering the Interstate Commerce Act consistently with the public interest. The record being clear that territorial averages do not measure the costs of North-South freight traffic, evidence of those costs should have been obtained.

We do think it necessary, however, to devote some attention to an argument advanced by appellants which bears directly upon the public interest aspects of the issues presented here — namely, Commission counsel's contention that there is more fairness in cost determinations based upon Rail Form A territorial average costs than there would be in determinations based upon special studies, simply because "Rail Form A data is readily available and does not include the biases which special

studies conducted by the contesting parties might understandably reflect" (I.C.C. Brief, p. 20). We think that this argument is not only fundamentally unsound, but that it carries the seeds of unfairness which, if ever sown, might permanently deprive the South of an opportunity to achieve economic equality with the rest of the country. For the truth is that Rail Form A averages are themselves biased in ways which inevitably work to the disadvantage of the South in interterritorial cases of this kind.

The single most important fact about territorial average costs is that these costs tend to vary directly with the degree of industrialization in the areas served by the railroads for which costs are being computed — that is, the greater the degree of industrialization in any area, the higher the territorial average costs of the railroads serving that area. The reason for this correlation between territorial average costs and the degree of industrialization in an area is that, with few exceptions, it costs considerably more to handle manufactured goods than to handle raw materials. Special equipment must be used to handle many manufactured articles — equipment which is more expensive, which usually requires greater maintenance, and which almost invariably has a much higher than average empty return ratio because it is not suitable for any return haul. Raw materials, on the other hand, usually move in the least expensive equipment in multi-carload quantities which permit a considerable saving in switching expense per car. Moreover, a high degree of industrialization of an area also often forces the railroads serving that area to perform other expensive services, such as commuter passenger service, which increase the Rail Form A average costs of railroads serving the industrialized territory.

The railroads serving the Northeastern portion of the

United States handle far more manufactured traffic than any other group of railroads in the country. The concentration of basic industry, such as iron and steel, in the Northeast is well known. But the dominance of that section of the country is even greater with respect to the manufacture of durable consumer goods, such as automobiles. Nearly all of the automobile parts used throughout the country are manufactured in the North. Hence, there is a very heavy movement of this important traffic both within the North and between the North and other sections of the country in which the Southern railroads do not participate. The South, on the other hand, is a deficit area with respect to most manufactured goods, so the movement of such goods within the South in which the Northern railroads do not participate is much more limited.

The result of this substantial difference in the degree of industrialization and in the amount of manufactured traffic moving in intrateritorial freight traffic in the North and in the South is that the Rail Form A average costs of the Northern railroads are the highest of any railroads in the country, and the average costs of the railroads serving the South are the lowest. (The Western railroads, serving an area less industrialized than the Northeast but more industrialized than the South, show average rail costs precisely in line with that degree of industrialization.) The following table* graphically depicts this situation:

	<i>Per Capita Value Added by Manufacture (1956)</i>	<i>Rail Form A Territorial Average Costs (1956)</i>
Official Territory	229	122
Western Territory	118	115
Southern Territory	100	100

*Table based upon data set forth at A. 722 and costs constructed from the Commission's Statement 2-58, which was used by the Commission here (325 I.C.C. at 24; A. 47). The indexes were constructed by treating Southern figures as 100 and calculating percentage deviations for the North and the West.

This table shows a clear correlation between the degree of territorial industrialization and the Rail Form A average costs of the railroads that serve that territory. Of course, the correlation is not a perfect one, since other factors also influence territorial average costs. In the North, for example, the inflating influence of manufactured traffic is partially offset by the greater amounts of coal traffic handled by the Northern railroads, since coal is one of the cheapest commodities to handle. And in the West, the inflating influence of manufactured traffic is only one of several factors (such as the necessity for crossing mountain ranges) which contribute to the higher cost level of those railroads. However, in each case, it is clear that the degree of industrialization of any section of the country is an important factor influencing the level of the territorial average costs of its railroads.

Since the level of territorial average costs is influenced so greatly by the degree of industrialization of the area served, such average costs do not precisely measure either the actual costs to a single railroad of carrying a single commodity or the relative costs of two groups of railroads in carrying the same commodity or commodities. No commodity will have cost characteristics precisely identical to the theoretical average commodity, even in a single territory; nor will the Rail Form A averages for any two groups of railroads be based upon the same amount and kind of service in both territories. In this case, for example, where the cost issue before the Commission was the relative costs of the Northern and Southern railroads in handling North-South freight traffic — a defined body traffic which by definition consists of the same carloads of freight in both territories — use of average costs derived from the different bodies of traffic moving in each territory to measure the relative costs of handling a movement of the same body of traf-

fic in both territories creates the false impression that Northern costs are substantially higher than Southern costs. This distortion can be corrected only by a careful analysis of the particular cost elements which are shown to be higher in the North because of the territorial averages. If the Commission refuses to make such an analysis, supplemented where necessary by special studies, the inevitable result is that it will conclude that Northern costs are higher on North-South traffic merely because the North is more industrialized than the South. Such an uncritical acceptance of unadjusted territorial average costs would, of course, only tend to perpetuate the very difference in the degree of territorial industrialization which brought about the higher Northern averages in the first place. Plainly, there is nothing at all that is fair about that.

In the final analysis, the real issue in this case is not whether the use of territorial averages to measure the costs of North-South traffic is fair but whether such a technique should be tolerated, despite its patent unfairness, out of considerations of administrative convenience. We submit that considerations of administrative convenience have no place in a case as important as this. Whatever may be the Commission's responsibility to obtain specific cost evidence in a routine rate case, it certainly is no burden upon the Commission to require such evidence where necessary to resolve the issues in a case involving basic economic relations between two sections of the country. Commission counsel's claim that this is inconsistent with the nature and purpose of the Rail Form A cost formula simply reveals a basic misunderstanding of that formula. The Commission's Cost Section was created and Rail Form A devised at the urging of these very appellees to dispel the illusion that the North was entitled to preferential class rates. Rail

Form A was properly applied in that case and accomplished its purpose. But now, by applying the averages produced by the formula to a situation in which such averages have no factual basis, the Commission would use the formula to recreate the same kind of preference with respect to divisions which it was intended to remove with respect to rates. Rail Form A was never intended to have such application. The district court quite properly refused to permit any such blind subjugation of the principle of uniformity.

II. THE COMMISSION VIOLATED THE ADMINISTRATIVE PROCEDURE ACT IN DEALING WITH THE CONTENTION THAT NORTHERN RAIL COSTS ARE NOT AFFECTED BY INHERENT TERRITORIAL DISADVANTAGES.

The district court correctly set aside the Commission's order in this case on the ground that the use of unadjusted territorial averages to measure the costs of handling North-South freight traffic was unsupported by evidence, and was thus contrary to the Administrative Procedure Act. However, in applying the standard of relative costs, the Commission committed further errors, which the district court directed the Commission to remedy upon remand. These errors constitute an independent ground upon which the judgment of the district court should be upheld.

In the proceedings before the Commission, the Southern Governors' Conference and the Southeastern Association of Railroad and Utilities Commissioners contended that even if there are cost differences in handling the relevant traffic, an inflation in the divisions of the

Northern railroads would not be justified unless "such differences are the product of the inherent advantages and disadvantages that go to make up the respective overall transportation conditions of the two territories" (Exceptions to Examiners' Recommended Report and Order, A. 1376). Our contention was based on the principle that neither existing overcapacity in the Northern rail transportation system nor any higher cost factor caused by temporary economic conditions in the North should be artificially perpetuated by casting any part of those costs on the people and economy of another territory. We pointed out that in *New York v. United States*, 331 U.S. 284, 315 (1947), affirming the Commission decision in *Class Rate Investigation*, 1939, 262 I.C.C. 447 (1945), this Court rejected the contention that Northern shippers should be granted preferential rate treatment in the absence of any "natural" differences in transportation conditions between the North and other sections of the country.

In the *New York* case, it was conceded that the North did enjoy immense advantages over other sections of the country; however, this Court agreed with the Commission that the Northern advantages were not "natural" or inherent, but were produced by such factors as the rate structure itself, which operated as a "man-made trade barrier" (331 U.S. at 315). In this case, we pointed out that a discriminatory divisions structure, "not justified by territorial conditions," likewise would preserve "man-made trade barriers." By burdening the South with the excess Northern costs, a divisional preference would tend to perpetuate both the existing Northern overcapacity of rail facilities and the different economic conditions now existing in the North and the South. Hence, we contended that in light of the principle announced and applied in the

New York case, the Commission should not, and indeed could not, prescribe an inflation in the Northern railroads' divisions based upon higher Northern costs without first considering the reasons for such costs. In no event would an inflation in divisions be proper unless a finding could be made that the inflation would not perpetuate artificial differences upon which it was based.

The Commission, as we read its decision, agreed with the principle laid down in *New York v. United States*—but it then proceeded to hold that this principle had been satisfied in this case because “other factors being equal, cost differences generally are the product of, and reflect, the inherent advantages and disadvantages in the two territories” (325 I.C.C. at 28; A. 51). Having thus held that the Northern cost differences are the product of “inherent disadvantages” rather than “other factors,” the Commission prescribed an inflation of 17 percent in the Northern railroads' divisions.

There is no evidence, and there are no reasoned findings, to support either the Commission's premise that the “other factors” which could account for higher Northern costs are “equal” in both territories or its resultant conclusion that higher Northern costs are the product of inherent territorial disadvantages. Throughout these proceedings, the Southern carriers contended that if Northern transportation costs are higher than those in the South, it is because of overcapacity in the Northern railroad system. Costs due to overcapacity are not inherent, as the Northern railroads have themselves admitted by seeking to rid themselves of such excess costs in a series of important control and merger cases. See, e.g. *Chesapeake & Ohio R. Co. — Control — Baltimore*

& Ohio R. Co., 317 I.C.C. 261 (1962); Norfolk & Western Ry. Co. and New York C. & St. L. R. Co. — Merger, 324 I.C.C. 1 (1964); Pennsylvania R. Co. — Merger — New York Central R. Co. 327 I.C.C. 475 (1966); Norfolk & Western Ry. Co. — Merger — Chesapeake & Ohio R. Co., I.C.C. Finance Docket No. 23832 now pending. The overriding purpose of these rail consolidations has been to eliminate the non-inherent costs which arise out of inefficient and wasteful duplication of facilities.

In the *Penn-Central* case, *Pennsylvania R. Co. — Merger — New York Central R. Co.*, 327 I.C.C. 475 (1966), the Commission expressly recognized the existence of overcapacity in the Northern railroad system (327 I.C.C. at 512):

"The Eastern District has, at this time, an oversupply of rail facilities inasmuch as the total volume of rail traffic in the district does not adequately support the existing railroad plant regardless of how the traffic may be apportioned or diverted from one railroad to another."

This single merger is expected eventually to produce savings in excess of \$80 million each year (327 I.C.C. at 501). Other Northern rail consolidations will further trim the present excess Northern costs. The C&O-B&O control arrangement is already producing savings of \$44 million a year, and will eventually yield greater savings when these two roads are merged (317 I.C.C. at 277). The N&W-Nickel Plate-Wabash merger was found to produce savings of \$29 million a year (324 I.C.C. at 80). The N&W-C&O merger would produce savings of \$36 million per year, and this figure would be increased to some \$50 million by the inclusion of other railroads. (I.C.C. Finance Docket No. 23832, Exhibits 10 and 11).

The cumulative effect of all these proceedings will be a complete re-structuring of the Northern rail network into two powerful systems, each capable of providing single-line service throughout the North. The inevitable result of this realignment will be, not only a massive elimination of duplication and waste in facilities, but, also, a profound change in traffic patterns to permit a more efficient handling of freight by the two systems. Evidence was offered in the Penn-Central merger case showing that some \$179 million a year can be saved from the elimination of unnecessary interchanges within the North (I.C.C. Finance Docket No. 21989, Exhibit FH-5). When all these potential savings are considered, it is plain that there is no inherent reason why Northern costs should be any higher than costs in the South.

The Commission's report and order in this case give no effect at all to the fact that there is substantial overcapacity and waste in the Northern rail system, even though the Commission conceded that Northern overcapacity contributed to Northern costs in a manner that cannot conceivably be related to inherent territorial disadvantages. The Commission permitted costs concededly inflated by such factors to be reflected in higher Northern divisions on the theory that the cost savings to be produced by Northern mergers had not yet been realized and were not precisely ascertainable (325 I.C.C. at 17-18; A. 39):

"It is true the savings expected from proposed mergers and consolidations are not reflected in the cost studies of record. However, the southern lines themselves have noted that mergers are now going forward in all territories, including the South. If and when such proposed mergers are ultimately approved and finally consummated in both groups the savings produced thereby will be *then* reflected in the respective unit costs." (emphasis supplied.)

Neither of the appellants suggests that this consti-

tutes an adequate disposition of our contention that any higher Northern costs found to exist should be regarded as the product of overcapacity, not inherent disadvantages. Commission counsel simply ignore the Commission's treatment of the issue while the Northern railroads prefer to quote from an order of the Commission directed, not to the question of inherent territorial differences, but to the question of whether evidence should have been considered "concerning the effect of proposed combinations and consolidations of rail carriers in Official Territory upon operating costs and revenue needs of said carriers" (B&O Brief, pp. 60-61). This order of the Commission has no relevance to the issue of inherent territorial differences, nor does it respond to that issue any more satisfactorily than the Commission's report. Our point is, not that merger savings should be treated as available to the carriers before they are realized, or that the Commission should prejudge pending mergers and assume that they will be approved, but that the very fact that such savings can be achieved if overcapacity and waste is eliminated demonstrates that higher Northern costs are not the product of "inherent" disadvantages. Whether or not Northern merger savings are ever realized, there is no reason to charge the South for the present Northern cost of overcapacity.

The force of this reasoning is in no way diminished by the Commission's observation that mergers were also proceeding in the South. For although our rail transportation system may have some degree of overcapacity so that Southern rail costs might also be reduced somewhat by Southern rail consolidations, such savings will not even begin to approach the savings achievable by Northern carriers, such as Penn-Central. Overcapacity in the North is simply far greater than in the South. In fact, the dispersion of industry out of the Northeast and into other territories, including the South, creates an in-

creasing demand for rail service in the South at the same time it reduces demand in the North, with the result that Northern overcapacity can be expected to increase while the Southern excess capacity will likely diminish (as discussed in detail at pp. 30-31, *infra*).

Certainly, the Commission did not find, and on this record could not find, that overcapacity in the North and in the South are equal. Thus, there is no foundation for the Commission's conclusion that "other factors" that might explain cost differences are "equal" in the two territories. Without findings or evidence on that critical point, the Commission's ultimate finding that Northern excess costs are the product of inherent disadvantages is unsupported by reasoned findings and substantial evidence as required by the Administrative Procedure Act (5 U.S.C. §§ 557, 706).*

In the district court, the Northern railroads sought to escape from this legal deficiency by claiming that the Commission's finding was merely a "comment" (B&O Brief, dated August 1, 1966, p. 128). However, the district court's action could not be defended on any such ground, for the Commission's disposition of the issue was plainly defective, however this aspect of its report was viewed. Thus, the district court pointed out (A. 342) that if the Commission's language constituted a finding that the Northern excess costs were the product of inherent disadvantages,

*The Commission's conclusion that cost factors, other than inherent territorial disadvantages, are "equal" in both territories is likewise contradicted by the Northern railroads' claim that their higher costs are caused by higher wage and tax levels (B&O Brief, p. 39, note 14). These higher average wage and tax levels are more than offset by the greater traffic density of the Northern carriers (A. 791). But even if they were not, what is important to note here is that such higher costs would be totally unrelated to inherent territorial disadvantages, since they would be the product of the long standing advantage which the North has maintained in economic and industrial development.

"then the Commission's conclusion (that higher Northern costs reflect inherent territorial disadvantages) is subject to attack because there are no findings as to what these inherent territorial disadvantages consisted of."

On the other hand, if the Northern railroads were correct, and the language was merely intended as a "comment," then,

"the Court must consider whether the Commission's failure to resolve the material issue raised with respect to that question can be reconciled with the express requirement of Section 8(b) . . . The Administrative Procedure Act requires findings on material issues of law" (*ibid.*).

In either case, the Commission's treatment of our contention was contrary to the Administrative Procedure Act. Because of the vagueness in the Commission's language, the district court found it impossible to determine with any certainty just what the Commission had done, so it directed the Commission to clarify and explain its disposition of our contention on remand.

This aspect of the district court's decision is clearly correct. In our view, the Commission's error lay in its holding without evidentiary support that "other factors" which might explain the higher Northern costs found to be applicable to North-South traffic were "equal" and that the Northern higher costs thus reflected inherent Northern territorial disadvantages. Otherwise, the Commission is chargeable with having only "commented," without ruling upon, our principal contention in the proceedings before it. However, the district court was clearly warranted in finding the Commission's language to be vague and in directing the Commission to clarify its meaning on remand. As Mr. Justice Cardozo

once said: "We must know what a decision means before the duty becomes ours to say whether it is right or wrong." *United States v. Chicago, M., St.P. & P.R. Co.*, 294 U.S. 499, 511 (1935). Accord: *Secretary of Agriculture v. United States*, 347 U.S. 645, 654 (1954); *Railway Labor Executives Ass'n v. United States*, 379 U.S. 199, 200 (1964).

Commission counsel continue to take cover in the same vagueness which puzzled the district court. In their Brief, they describe the Commission's position as follows (I.C.C. Brief p. 52):

"[T]he Commission simply determined that, in a divisions case where the carriers were found to be efficient, their services were of equal importance to the public, and where the fairness of existing divisions and the need for revised divisions was assessed on the basis of relative fully distributed cost of service, *it was appropriate to conclude that cost differences reflect inherent territorial disadvantages, insofar as that consideration is relevant under Section 15(6).*" (Emphasis added.)

Is the conclusion referred to a disposition of our contention? The choice of language seems deliberately vague, but as in the case of the Commission's own language in the report, we can only interpret this as an admission that the decision in this case does rest upon a finding of inherent territorial disadvantages. But if that is so, the finding remains unsupported by evidence. Counsel for the Commission do not even now cite a single piece of evidence which would relate cost differences in the North to inherent territorial disadvantages.

The Northern railroads have maintained a different position. They say that the Commission is not required to follow the principle of *New York v. United States*. In their view, cost differences alone are a sufficient basis

for divisions without regard to the causes of the higher costs. They concede that the Commission has not even considered whether the costs upon which it acted were based upon inherent territorial differences and argue that in doing so the Commission was justified because this would require "a tremendous factual inquiry" (B&O Brief, p. 59). Their reasons for taking this position are obvious. The Northern railroads know that their higher costs do not derive from inherent disadvantages. Otherwise, of course, they would not continue so anxiously to seek the benefits that accompany consolidation of rail facilities. Obviously, the Northern railroads cannot simultaneously urge that their high costs are inherent and that they should be permitted to reduce their costs through mergers. Thus, the Northern railroads' position here is the same which they pressed in district court — that the Commission merely "commented" on our contention and actually based its decision upon cost differences in the two territories which may have no connection at all with inherent territorial conditions.

But as the district court pointed out, if that is what the Commission has done, it has failed completely to resolve some of the principal issues before it. Can the Commission prescribe a basis of divisions which prefers one section of the country over another where that preference will tend to perpetuate the very economic differences between those sections upon which it is based? And even if the Commission has such power, under what circumstances should it be exercised? Why should the North, as a railroad rate territory, be entitled to maintain, partly at the expense of the South, a rail transportation system far more extensive than that which the South can afford to build for itself? Why should the South be forced to subsidize the uneconomic conse-

quences of attempting to maintain facilities that are partly unneeded in the North? And why should the people of the entire country be deprived of the benefits that flow from a unified national economy unhampered by artificial barriers that prevent the most efficient allocation of transportation resources?

Ironically, one of the leading causes of Northern overcapacity is that industry which was formerly concentrated almost exclusively in the North is now moving out into other territories, including the South. As the Commission itself found in the *Penn-Central Merger* case (Recommended Report, F.D. 21989, p. 198, adopted as the finding of the Commission, 327 I.C.C. at 481):

"We believe that one of the primary explanations for this trend [the decline in rail traffic in the North] lies in the changing structure and location of industry in the Eastern District and the nation as a whole or the 'industrial mix'. Historically, the Eastern District has been noted for its heavy industry, and the fact that it has supplied the nation with steel and other basic items which have previously moved by rail from Pittsburgh and other eastern industrial points to the western, northern and southern extremities of the nation. The growth of major population centers throughout the nation, however, which are able to support the necessary high fixed investment of heavy industry has caused a certain degree of 'decentralization' of industry. This, in many instances, has eliminated, or at least restricted, eastern producers from such markets and thereby curtailed the use of rail service to some undocumented extent."

The inflation prescribed in the divisions of the Northern railroads in part because of the costs due to Northern overcapacity would require the South to subsidize excess Northern rail facilities at the expense of investing in its

own rail transportation system. Such a subsidy would blunt the cost stimulus which would encourage the North to make further reductions in inefficiency and over-capacity. But worst of all, it would retard the very economic transformation upon which the South must depend if it is to achieve equality of economic opportunity with the North. For if the Southern railroads are deprived of the revenues necessary to construct new facilities for businesses desiring to move South, and if those revenues are diverted to the Northern railroads thus permitting the maintenance of facilities that would otherwise be uneconomic, the inevitable result will be a strong tendency for business to remain in the North even in instances where all other economic factors indicate that it should move South.

As already noted, the Commission found in the *Class Rates* case that there are no inherent differences in transportation conditions between North and South, and this Court agreed with that conclusion in *New York v. United States* (331 U.S. at 315). There is no evidence in this case which would support a contrary view. In the absence of any inherent disadvantages, the question which must be confronted is why one territory should be burdened with any part of the burden of higher costs in another territory — costs which are higher because of the benefits of industrialization and a developed economy, because of a transportation system with excess capacity for providing freight service, and because of great population centers requiring extensive commuter facilities. Preferences in rates or divisions preserve and rigidify these territorial differences, rather than promote their disappearance.

The Northern railroads suggest (B&O Brief, pp. 61-62) that the amount of money involved is too small for us to be much concerned. To support this claim they seek to

compare the revenues involved with gross revenues of the railroads. By doing so, however, they seek to submerge the fact that the shift in revenues represents an inflation ranging up to 45 percent on the traffic to which it applies. Obviously, that is the relevant comparison here, for it is certain to be the primary concern of the Southern railroads when they consider rate levels on traffic moving between the North and the South. Since the Southern economy is vitally dependent upon trade with the North, we must be concerned with any discrimination that is likely to impede that commerce. Moreover, a fundamental question of principle is involved here: whether the South should be compelled to pay *any* amount — no matter how great or small — of higher Northern rail costs that do not reflect inherent territorial disadvantages. Either the South is entitled to equal treatment or it is not. That is the central issue before this Court.

III. THE COMMISSION'S ACTION IN PRESCRIBING AN INFLATION IN THE NORTHERN RAILROADS' DIVISIONS VIOLATES THE ADMINISTRATIVE PROCEDURE ACT EVEN IF ITS CONCLUSION THAT THE NORTH SUFFERS FROM INHERENT TERRITORIAL ADVANTAGES IS ACCEPTED.

These appellees also contended before the Commission that whether or not excess Northern costs were found to be the product of inherent advantages, the imposition of any part of that cost burden on the South would be improper and unjustified unless the North were found to be unable to support its own cost burden. Accordingly, when the Commission's Examiner recommended that the Northern railroads be granted an inflation in their divisions because of supposedly higher costs without such a

finding, we took specific exception to the recommended report on the ground that "the burden of that increase could not properly be imposed upon the Southern public, as it was here, without an effort first to determine whether the North is capable of supporting its own transportation system through rate increases" (A. 1388). The Commission failed to rule on our exception, and failed to make any findings which would support the notion that a part of the Northern cost burden should be borne by the South. This constitutes an independent error supporting the decision of the district court.

The principle that each territory is primarily responsible for carrying its own transportation cost burden has been consistently followed by the Commission for more than thirty years. In *New England Divisions*, 126 I.C.C. 579, 599 (1927), the Commission, speaking through Commissioner Eastman, stated:

"The dangers in (the) . . . assumption that deficiencies in local earnings must inevitably be made up on interchange business at the expense of connecting lines are obvious. Communities and the roads which serve them might too readily arrive at the conclusion that they are 'unable' to increase local rates and, in disregard of the principle of self-help, unduly rely upon others to carry their burdens."

This principle of primary local responsibility through equality of divisions has since been applied in numerous cases involving the division of interterritorial joint rates, including those accruing on North-South traffic. Equal-factor divisions were prescribed for North-Southwest traffic in *Official-Southwestern Divisions*, 287 I.C.C. 533 (1953), and are still in effect today. Equal factor divisions were also prescribed as to North-Midwest traffic in *Official-Western Trunk Line Divisions*, 316 I.C.C. 351 (1962), the Commission noting that "the common level

of class rates in the two territories argues strongly for a single scale of divisional factors" (316 I.C.C. at 365). And when that scale was set aside as improperly constructed (*Atchison, Topeka & Santa Fe Ry. Co. v. United States*, 255 F. Supp. 584 (1965)), it was replaced by mutual agreement with another equal-factor scale, which was approved by the Commission in an order dated April 8, 1966. The only traffic other than North-South traffic as to which unequal divisions are now in effect is Midwest-Mountain Pacific traffic. However, since higher rates apply throughout Mountain-Pacific territory, the inflation in the Mountain-Pacific divisions scale amounts simply to an arrangement whereby the railroads of Mountain-Pacific territory can retain the higher rates paid by the people of that territory (*Akron, Canton & Youngstown R. Co., et al. vs. Atchison, Topeka & Santa Fe Ry. Co., et al.*, 321 I.C.C. 17, 77 (1963), quoted in *Chicago & N.W. R. Co. v. Atchison T.&S.F. Ry. Co.*, 387 U.S. 326, 357-358 (1967)).

The principle of equality in divisions has also been applied in dividing the joint rates accruing on North-South freight traffic. In *Divisions of Rates, Official and Southern Territories*, 234 I.C.C. 175 (1939), the Southern railroads were denied a generally higher basis of divisions, despite the Commission's recognition "that transportation costs on the traffic here considered may properly be considered to be higher in the South" (234 I.C.C. at 189). The Southern railroads were permitted a divisions differential only where higher rate levels prevailed in the South, as a way to retain the higher rates paid by Southern shippers: "Where no such increment is to be found in the rates . . . fair application of the principle demands that the divisions of each group of carriers be on the same basis" (234 I.C.C. at 192-193). Following the Commission's decision in the *Class Rates* case (*Class*

Rates Investigation, 1939, 262 I.C.C. 447 (1945), differences in the rate levels of interterritorial North-South traffic and intraterritorial Northern traffic substantially disappeared. Accordingly, in *Official-Southern Divisions*, 287 I.C.C. 497 (1953), the Commission removed the limited divisions differential in favor of the Southern lines, and prescribed the equal-factor basis of divisions which was in effect until the order now in question.

The Commission's order in this case thus represents a radical departure from the principle which has previously governed the decision of divisions cases.* The South is today the only territory in the country which is required to subsidize the railroads of another territory through divisions preferences unrelated to higher rates in the favored territory.** An essential question in this case is whether the Commission's action in abandoning its previous policy and establishing this preference has

*Commission counsel's sole response to this contention is the unreasoned assertion that these cases do not "stand for the proposition . . . 'that the primary responsibility for meeting the cost and revenue needs of the railroads of any territory lies with the people and the industry of that territory'" (I.C.C. Brief, p. 51, note 46). This hardly seems adequate unless Commission counsel expect this Court either to read all these lengthy Commission reports itself in a search of a different explanation or to accept on faith the assertion that the district court misinterpreted the reports.

**Commission counsel's suggestion that Section 15(6) was designed for a purpose contrary to the principle of primary local responsibility (I.C.C. Brief, p. 51, note 46) is as unsound as it is unsupported. Certainly, the *New England Divisions* case, in which Commissioner Eastman announced the principle, does not support counsel's suggestion. In that case, this Court stressed the absolute necessity of putting a part of the burden of New England transportation costs upon other sections of the country, saying (261 U.S. at 192).

"To have raised the additional revenues needed by the New England lines wholly by raising the rates in New England — particularly when the rates west of the Hudson were raised much less — might have killed New England traffic."

In contrast, no consideration at all has been given to the possibility of raising Northern rates in this case.

been justified as required by law. We submit that it has not been.

The Commission, of course, is not precluded from changing its mind. We do not contend that Section 15(6) forever binds the Commission or the nation's railroads to a system of divisions whereby each territory is primarily responsible for the costs of its own railroad transportation system, although we cannot help but agree with Commissioner Eastman that "[t]he dangers" in any other approach "are obvious" (126 I.C.C. at 599). In any event, abandonment of equality deserves an explanation. The Commission erred in ignoring our exception,* and in refusing to consider the respective capabilities of the North and South to pay for Northern excess rail costs.

Furthermore, the report violates the well-established rule that when an agency departs from previously adopted principles, it must explain and spell out the legal basis for its decision. *Secretary of Agriculture v. United States*, 347 U.S. 645, 653 (1954). The Commission in this case offered no explanation for its displacement of the principle of primary local responsibility. As the district court pointed out, such a radical departure from prior Commission policy should have been explained (A. 351). Even now, counsel for the Commission make no effort to explain the departure, nor do they refer to evidence that the North cannot bear its own cost burden, since no such evidence exists.**

The Commission's action in abandoning the principle

*Section 8(b) of the Administrative Procedure Act expressly condemns this aspect of the Commission's action, for it provides: "The record shall show the ruling on each . . . exception presented" (5 U.S.C. §557(c)).

**The Commission's Brief contributes only one footnote (I.C.C. Brief, p. 54, note 48) to this issue, and it makes no mention of the Commission's failure to spell out the reasons for abandoning the principle of primary local responsibility. The Commission's view seems to be that there is no responsibility, "special" or otherwise, to elucidate the basis for its decision here.

of primary local responsibility has especially harsh consequences here, since it permits the claimed higher rail costs of the North to be imposed upon the South. The evidence in this case demonstrates that the North is still by far the most prosperous territory in the United States. In *New York v. United States* this Court took specific note of the wide disparity between Northern and Southern economic development. In the two decades that have passed since that decision, little has occurred to alter the relative economic situation in the two territories. Despite an 849 per cent increase shown in "Value Added by Manufacture" in the South between the years, 1935 and 1956 (A. 72), the South still contributes only 11.7 per cent of the "Value Added by Manufacture" in the country as a whole. The per capita statistics are to the same effect (*ibid*). In every category shown, the South still lags far behind the North in wealth and in level of economic activity. The Commission itself found that both the freight revenues and the net operating income of the carriers in Northern territory far outstripped those of the Southern railroads (325 I.C.C. at 13-14; A. 33-34), and that there was no such difference between the revenue needs of the Northern and Southern carriers as would justify a divisions preference (325 I.C.C. at 49; A. 79).

The South, of course, has realized gains as a result of the establishment of the principle of uniformity in *New York v. United States*. But the orders in this case would effectively nullify those gains. Although the orders here operate *directly* only upon the revenues of the railroads and not upon rates, an inflation in the Northern railroads' divisions on North-South freight traffic will inevitably have an impact not merely upon the Southern railroads' revenues but also upon the transportation system and, consequently the whole economy of the South. Because the earnings of the Southern railroads have consistently

been found by the Commission to be inadequate,* any action which would further reduce those rates of return for the benefit of the Northern railroads would necessarily result either in a diminution of rail services in the South, or in an increase in the rates which Southern shippers must pay for such services, or both.

It is obvious that the Southern railroads cannot spend money for maintenance and expansion of their services unless they have the money to spend. Consequently, if the Southern railroads have no excess revenues to spend for this purpose in their current earnings, a substantial decrease in those earnings would inevitably have an impact upon the railroads' operations.

The only alternative to a substantial diminution in the quality of rail service available to the people of the South would be a substantial increase in rates. Any substantial rate increase would obviously put these shippers at an even more serious disadvantage in their efforts to compete with shippers located closer to the center of population.

The extent of this unfairness becomes even more apparent when it is realized that the Northern railroads'

*The Commission has consistently⁴ stated in its own proceedings that the rates of return of the Southern railroads are inadequate. In *Increased Freight Rates, 1951*, 284 I.C.C. 589, 612 (1952) the Commission found rates of return of these railroads to be substandard, even though they were then substantially higher than they have been in recent years, saying:

"Judged by any standard shown of record, the rates of return earned or prospectively to be earned by the railroads by the districts and regions specified in our former reports in this case, are substandard."

And only last year, in *Increased Freight Rates, 1967*, 329 I.C.C. 854 (1967), the Commission reiterated this finding (329 I.C.C. at 872) in holding that the Southern railroads were entitled to another general freight rate increase designed to generate the revenues necessary to permit them to maintain their current level of service.

primary duty is to serve the competitors of Southern industry. It is common knowledge that most of the buying power of the country is concentrated in the North and that, notwithstanding the substantial geographical disadvantage which must be overcome, industries located in other parts of the country must seek to reach that market. The Commission itself recognized this situation in its report in the *Class Rates* proceeding (262 I.C.C. at 696):

"Official territory is the greatest consuming territory in the country, and is the market that nearly all manufacturers desire to reach, particularly where they have a surplus of their products to sell. In shipping to official territory, manufacturers in the other territories not only have the disadvantage of location, but are subjected to an additional burden in those instances where they must pay class rates on a much higher level than their competitors in official territory. This situation reacts to the disadvantage of manufacturers in the other territories, and to the advantage of those in Official Territory, tends to restrict the growth and expansion of the manufacturers in the other territories, and to some extent, to prevent the establishment of new manufacturing plants in those territories."

Moreover, the alternative of a rate increase is particularly ominous here since revenues lost to the Northern railroads through their inflated divisions might be made up, in part at least, from an increase in intrastate rates within the South — rates which are of vital importance both to the growth of an independent Southern economy and in their effect upon the overall ability of Southern shippers to compete in the markets of the North. Over the protest of some of the appellees (see e.g. *King v. United States*, 344 U.S. 254), the Commission has successfully asserted the power under Section 13 of the Interstate Commerce Act to take into account the entire

financial condition of the railroads, rather than restricting itself to those aspects related to intrastate commerce, in passing upon the adequacy of intrastate rates.* Under this rule, any loss of revenues in this interterritorial divisions case may later be used by the Commission as a basis for compelling intrastate rate increases. Hence, in future Section 13 proceedings the very rates of return which the Commission has here depressed to meet the burden of claimed higher transportation costs in the North may have to be augmented by increases in intrastate rates.

The basic unfairness of imposing the burden of higher Northern transportation costs upon the South is apparent where the economy of the South is demonstrably and dramatically weaker than that of the North, as the record here unquestionably shows that of the South to be. The inevitable effect of any divisional structure that accords higher divisions to the Northern railroads would be to improve the rail transportation system of the North at the expense of the Southern public, for any transfer of divisional revenues to meet the needs of the Northern railroads could not fail to have an adverse impact upon rail transportation in the South, either

*The Commission has repeatedly utilized Section 13 orders based upon this theory as a source of additional revenues for the Southern railroads. Indeed, as a result of such proceedings or the threat of such proceedings, intrastate rate increases have been effected in each one of the States represented here during the period covered by the rate of return date set out above. See, e.g., *Louisiana Intrastate Rates and Charges*, 284 I.C.C. 467 (1952); *Alabama Intrastate Express Rates and Charges*, 288 I.C.C. 423 (1953); *Mississippi Intrastate Freight Rates and Charges*, 291 I.C.C. 39 (1953); *Louisiana Intrastate Freight Rates and Charges*, 291 I.C.C. 279 (1954); *North Carolina Intrastate Freight Rates and Charges*, 293 I.C.C. 541 (1954); *Tennessee Intrastate Freight Rates and Charges*, 294 I.C.C. 633 (1955); *South Carolina Intrastate Freight Rates and Charges*, 296 I.C.C. 159 (1955); *Alabama Intrastate Rates and Charges on Coal, Lumber, and Scrap Iron*, 297 I.C.C. 241 (1955); *Louisiana Intrastate Passenger Fares*, 305 I.C.C. 137 (1958); *Louisiana Intrastate Freight Rates and Charges*, 306 I.C.C. (1959).

through increased freight rates or through a diminution in the availability of rail services, facilities and equipment, or both. Consequently, a transfer of divisional revenues to the Northern railroads would bear heavily upon the Southern public regardless of the reasons that might be offered to support it.

The record shows that the Southern people are fighting a long uphill struggle in their efforts to raise their standard of living to that already enjoyed in other parts of the country. In such a situation the South cannot properly be expected to make a disproportionate contribution to the maintenance of the rail system in the North. The South has many needs of its own which must be met, and we are striving mightily to meet them despite the handicap of a still woefully inadequate industrial base. There is simply nothing whatever in the record to justify a further shackling of the efforts of our people by requiring them to subsidize the rail transportation system of the North.

The undisputed facts show no basis for the Commission's action in imposing the burden of the allegedly higher Northern transportation costs upon the Southern people. That action is therefore unlawful under Section 10(e) of the Administrative Procedure Act.

CONCLUSION

When the claims being pressed by the Northern railroads in this case are considered against the background of the historical context out of which they arose, it is plain that what is involved here is simply another effort by Northern interests to obtain preferential treatment in rail transportation charges, without regard to the fact

that the inevitable effect of such preferences, whether they occur in rates or divisions, is to keep the South in a permanent position of economic inferiority. Whether the fashionable justification is inherent Northern disadvantages, as here, or inherent Northern advantages, as in the *Class Rates* case, and whether Northern rail costs are argued to be higher than those in the South or lower, the result is always the same. Thurman Arnold summed it up almost thirty years ago in a speech delivered August 22, 1941 at Hot Springs, Arkansas:

"The industrial East has been the Mother Country. The South and West have been the colonies. The colonies have furnished the Mother Country with raw material. The Mother Country has been exploiting the colonies by selling them manufactured necessities at artificially controlled prices . . . How this all happened in a complicated process. Big business has treated the West and South primarily as a source of raw materials, not as a place to manufacture and sell finished products at competitive prices.

"This is the age-old principle of colonial empires. It is dictated by the necessity of keeping up dividends in the Mother Country against cheaper local competition in the colonies. The methods of maintaining control of industrial markets in the South and West are based on the power of tightly organized cartels to control supply, transportation and distribution in such a way as to put new competing enterprise in the colonies under a continuing handicap."

In refusing to permit the Interstate Commerce Commission to promote this kind of policy without reasoned findings based upon substantial evidence as required by the Administrative Procedure Act, the district court has done nothing more than to guarantee the South the minimal protections of the law against this threat. The rightful province of the Commission has in no sense been in-

vaded, for the Commission is still free to decide the case as it sees fit so long as it observes legal requirements.

For the foregoing reasons, the judgment of the United States District Court for the Eastern District of Louisiana should be affirmed.

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